Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	
	)	

WESTERN WIRELESS COMMENTS ON REFORM OF THE RURAL HIGH-COST SUPPORT SYSTEM

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REFORM OF THE RURAL HIGH-COST SUPPORT SYSTEM

Western Wireless Corporation ("Western Wireless") submits its comments on the Joint Board's Public Notice regarding reform of the high-cost universal service support mechanisms for carriers serving rural areas. 1/ As explained herein, more consumers today have access to telecommunications services in rural areas because of the entry of new universal service providers into the marketplace, consistent with Congressional mandates, Commission policies, and state commission designations of eligible telecommunications carriers ("ETCs"). Clearly, universal service has been "advanced" by the entry of competitive ETCs ("CETCs") into the universal service marketplace. In this proceeding, Western Wireless demonstrates that universal service can also be "preserved" by establishing an efficient funding mechanism for all carriers, rather than basing support on each carrier's embedded costs, which may maximize individual carriers' universal service funding, but has not led to better service to rural America.

1/ Public Notice, "Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support," 19 FCC Rcd 16083 (Jt. Bd. 2004) ("*Public Notice*").

INTRODUCTION AND EXECUTIVE SUMMARY

Western Wireless commends the Commission and the Joint Board for initiating this broad-ranging proceeding regarding issues including the "structure of universal service support mechanisms in areas served by rural carriers, including the cost basis of support and the method of calculating support." 2/ Today's hodge-podge of rural high-cost universal service funds is based largely on rate-of-return regulation, which impedes efficiency, obstructs competition, facilitates fraud, waste, and abuse, and disserves rural consumers. 3/

The time is right to reform universal service based upon today's telecommunications marketplace and eliminate those regulations that serve to retard and jeopardize, rather than preserve and advance, universal service. The answer does not lie in trying to develop a new, separate set of rules for funding CETCs, while allowing the ILECs to continue to operate under a monopoly-inspired form of regulation, *e.g.,* guaranteed rate of return on embedded costs, regardless of efficiency and effectiveness in serving rural areas. Instead, the Joint Board should

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2/ *Id.*, ¶ 7. *See also Federal-State Joint Board on Universal Service*, Order, 19 FCC Rcd 11538 (2004) ("*Referral Order*").

3/ *See Referral Order*, ¶ 11 n.29 (citing *Elimination of Rate of Return Regulation of Incumbent Local Exchange Carriers*, Western Wireless Petition for Rulemaking, RM-10822 & CC Docket No. 96-45 (filed Oct. 30, 2003) ("*WW ROR Petition*")); *WW ROR Petition* (attached hereto as Exhibit 1); Western Wireless Reply Comments, RM-10822 & CC Docket No. 96-45 (filed Feb. 13, 2004) ("*WW ROR Reply*") (attached hereto as Exhibit 2); Economics & Technology, Inc., "Lost in Translation: How Rate of Return Regulation Transformed the Universal Service Fund for Consumers into Corporate Welfare for the RLECs," Appendix A to *WW ROR Reply* ("*Lost in Translation*") (attached hereto as Exhibit 3).

Economics & Technology, Inc. has also prepared a new analysis in response to the paper by Dr. Dale Lehman, submitted by NTCA and OPASTCO, purporting to refute *Lost in Translation*. *See* Economics & Technology, Inc., "Striking A Nerve: ETI's Response to Efforts to Discredit 'Lost in Translation'" (attached hereto as Exhibit 4).

develop, and the Commission should adopt, new rules governing universal service that provide funding based upon the long-standing "principles of competitive neutrality" and portability, which the courts have confirmed are "dictated" by the "statutory command" of section 254(e). 4/

Instead of trying to address CETC issues in isolation, the Commission and the Joint Board should take this opportunity to replace the existing, non-functional system with a new system for funding all "rural carriers" – including rural incumbent local exchange carriers ("rural ILECs" or "RLECs"), larger ILECs that serve rural areas, and CETCs. 5/ There is no substance behind the oft-repeated, but facile, slogan that "*one size does not fit all*." In the universal service funding context, maintaining different funding systems for different sizes or types of carriers violates competitive and technological neutrality, undermines competition, and harms consumers. A new rural high-cost support mechanism based on forward-looking economic costs would be the best way to develop a ***unified*** system that advances the interests of ***consumers*** in rural areas and best serves the goals of economic efficiency and competitive neutrality.

Most critically, the Joint Board and the Commission need to keep in mind that "[t]he purpose of universal service is to benefit the customer, not the carrier." 6/ Some have expressed "concerns with policies that use universal service

4/ *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 622 (5th Cir. 2000) ("*Alenco*").

5/ Western Wireless objects to the use of the term "rural carriers" to mean only "rural ILECs," since Western Wireless and other wireless carriers are most assuredly rural carriers. *Cf. Public Notice,* ¶ 3 n.10.

6/ *Alenco*, 201 F.3d at 621; *see also Primary Line/ETC Designation RD*, ¶ 57 & n.146.

support as a means of creating 'competition' in high cost areas." 7/ Providing portable, competitively neutral high-cost support funding to competitive entrants most assuredly does *not* artificially "create competition." Rather, it removes an artificial barrier to competition that was imposed by the pre-existing, monopoly-oriented universal service regime. To be sure, competition might be a means, not an end – but competition is widely recognized as the most effective means to motivate service providers to bring *benefits to consumers* such as lower prices and technological innovation that drives reduced costs and improved services. The Telecommunications Act of 1996 ("1996 Act") is rooted on the proposition that competition will bring benefits to consumers – and that is exactly what is happening today in rural markets. Many wireless carriers, including Western Wireless, have already filed reams of information in this docket documenting how universal service support facilitates the build-out of infrastructure in high cost areas. 8/

However, if regulators were to make the unwise and unlawful decision to provide high-cost support only to a single, incumbent carrier in certain areas *because* of that carrier's high cost, 9/ they would ensure that such incumbents

7/ *See Primary Line/ETC Designation RD*, Separate Statement of Commissioner Kevin J. Martin, Dissenting in Part, Concurring in Part.

8/ *See, e.g.,* Western Wireless Comments, CC Docket No. 96-45 (filed May 5, 2003) (providing extensive evidence of consumer benefits generated by competition in the marketplace for universal service in rural America).

9/ *See, e.g., Primary Line/ETC Designation RD*, Separate Statement of Billy Jack Gregg, Director of the Consumer Advocate Division, Public Service Commission of the State of West Virginia (arguing for adoption of "benchmarks," based on amounts of high-cost funding received by rural ILECs, that would determine "areas of this country where it is so expensive to provide continue to operate at the highest possible cost (*i.e.*, as inefficiently as possible) 10/ and would preclude consumers in those areas from receiving the services available in urban areas. Such an approach would prevent competitive entry unless competitors can not only provide efficient, high-value service to consumers, but also be so much more efficient and create so much more value that it can also offset the financial subsidization provided by the government exclusively to the incumbent. 11/ Such a regime would preclude the engine of intermodal competition from motivating efficiency and higher value – to the detriment of rural consumers. This is certainly not the vision of the pro-competitive 1996 Act.

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service that it makes no sense to have more than one carrier subsidized by the federal universal service fund").

10/ *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, First Report and Order, 12 FCC Rcd 8776, 8933, ¶ 289 (1997) ("*Universal Service First Report and Order*"), *subsequent history omitted* ("If the [competitive entrant] can serve the customer's line at a much lower cost than the incumbent, this may indicate a less than efficient ILEC. The presence of a more efficient competitor will require that ILEC to increase its efficiency or lose customers.").

11/ *See Western Wireless Corp. Petition for Preemption of Statutes and Rules Regarding the Kansas State Universal Service Fund Pursuant to Section 253 of the Communications Act of 1934*, Memorandum Opinion and Order, 15 FCC Rcd 16226, 16232, ¶ 8 (2000) ("*Kansas USF Declaratory Ruling*") ("We would be concerned about a universal service fund mechanism that provides funding only to ILECs. A new entrant faces a substantial barrier to entry if its main competitor is receiving substantial support from the . . . government that is not available to the new entrant. A mechanism that makes only ILECs eligible for explicit support would effectively lower the price of ILEC-provided service relative to competitor-provided service by an amount equivalent to the amount of the support provided to ILECs that was not available to their competitors. Thus, non-ILECs would be left with two choices – match the ILEC's price charged to the customer, even if it means serving the customer at a loss, or offer the service to the customer at a less attractive price based on the unsubsidized cost of providing such service. A mechanism that provides support to ILECs while denying funds to eligible prospective competitors thus may give customers a strong incentive to choose service from ILECs rather than competitors. Further, we believe that it is unreasonable to expect an unsupported carrier to enter a high-cost market and provide a service that its competitor already provides at a substantially supported price. In fact, such a carrier may be unable to secure financing or finalize business plans due to uncertainty surrounding its . . . government-imposed competitive disadvantage. Consequently, such a program may well have the effect of prohibiting such competitors from providing telecommunications service, in violation of section 253(a).").

I. ESTABLISH A NEW, "UNIFIED" SYSTEM FOR FUNDING COMPETITIVE AND INCUMBENT CARRIERS ALIKE

A. A Separate System for Funding CETCs Would Disserve the Public Interest

In response to the Joint Board's request for comment on whether a CETC "should receive support based [on] its own costs, the incumbent's costs, the lesser of its own or the incumbent's costs, or some other estimate of costs," 12/ Western Wireless respectfully submits that all ETCs serving a given geographic area – CETCs and ILECs alike – should receive support based on the forward-looking costs of the least-cost technology to provide the service defined as "supported universal service" to the area. By contrast, creating a separate system for funding CETCs would flunk the criteria of: (1) effectively controlling fund growth; (2) compliance with the law; and (3) competitive neutrality (*i.e.*, neither artificially promoting nor artificially restricting competition in rural areas). Instead of focusing on carriers' desire to recover revenue requirements, the Joint Board and the Commission should focus on addressing the needs of rural ***consumers*** for affordable services that are comparable to those available in urban areas.

1. ***Controlling Fund Growth***. First, adjusting CETC funding formulas is a misguided way to control the growth of universal service funding, and, in fact, could very well lead to ***increased*** universal service support. Today, a CETC receives the per-line equivalent of the support received by the ILEC in the same service area. In most areas, the per-line equivalent universal service support is less than $20.00

12/ *Public Notice*, ¶ 36.

per line. So, even if a CETC invested millions of dollars to provide service in a high-cost area, it is limited to $20.00 per customer served, whereas if the CETC's costs were used to determine support levels, it could be eligible for substantially greater universal service support – in many cases, amounting to $50.00 or more per line. This is especially true given that CETCs are entering the universal service market with limited market share and their costs would initially be spread out over a limited number of customers.

In its attempt to control the growth of universal service funding, the Commission should not turn a blind eye on the main causes for fund growth. *CETC funding is not the main cause of fund growth*. Rather, recently released data confirm that dramatic increases in funding to *ILECs* are the principal cause of fund growth. Although wireless carriers serve more subscriber connections than ILECs (approximately 160 million, by comparison to the ILECs' 152 million, as of year-end 2003), 13/ CETCs continue to receive only a small minority of high-cost funding – about 7.1% in 2004. 14/ The Joint Board Staff's Monitoring Report issued earlier this week demonstrates that high-cost funding to ILECs increased by $1.499 Billion

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13/ FCC, *Statistics of Common Carriers 2003/2004*, Tables 5.2 (End-User Switched Access Lines Reported) & 5.6 (Measures of Mobile Wireless Customers) (released Oct. 12, 2004).

14/ Universal Service Monitoring Report, CC Docket No. 98-202, Prepared by Federal and State Staff for the Federal-State Joint Board on Universal Service in CC Docket No. 96-45 (released Oct. 12, 2004), Tables 3.1 and 3.2 ("*Monitoring Report*") (available at http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/Monitor/mr04-0.pdf). The *Monitoring Report* is more reliable than USAC reports, since "USAC's quarterly filings include projections of support for CLECs that have applied for, but not yet received, ETC status. These support amounts have been removed from the data reported here if the CLEC failed to attain ETC status before the end of the year." Id. at page 3-2 n.6. Note that the *Monitoring Report* erroneously uses the term "CLECs" when it apparently intends to refer to CETCs, even though non-CLEC wireless carriers receive the majority – although certainly not all – of CETC funding.

from 1999 (the first year that CETCs began receiving funding) through 2004, representing 86% of the total high-cost fund growth during that period. By contrast, during the same time period, high-cost funding to CETCs increased by only $243 million. 15/ Over the past three years (2001 through 2004), total high-cost universal service funding has increased by $839 billion, of which only $227 million or 27.1% of fund growth is attributable to CETCs and the remaining $612 million or 72.9% of fund growth is attributable to ILECs. Moreover, CETCs' responsibility for the growth of the universal service fund as a whole is minimal: total universal service funding has increased by $1.842 Billion over the last three years; only 12% of this fund growth is attributable to CETCs. 16/

It should be noted that examination of percentage growth rates in CETC funding is not a useful measure, since CETCs only very recently began to receive funding. Even relatively small funding increases may appear large in percentage terms when divided by zero, or when divided by the very small numbers

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15/ *Id.* Wireless CETCs are using funds to build out new infrastructure in rural areas and are increasing the number of rural subscribers at a rapid pace, by contrast to ILECs, whose networks are mature and whose line counts are either unchanged or declining. Note that even if one excludes funding from the Interstate Common Line Support ("ICLS") and Interstate Access Support ("IAS") funds, which represent subsidies that ILECs formerly recovered implicitly through access charges that have been transferred into explicit universal service funds, ILEC funding still increased by $223 million from 1999 through 2004 – 56% of the total non-IAS/ICLS fund growth.

16/ Data on CETC and ILEC High Cost Support are based on the Monitoring Report, Tables 3.1 & 3.2. Data on all other mechanisms are based on USAC "Fund Size Projections" appendix M5 (2001-2004).

representing the amounts of funding that CETCs received in the past. Below, we discuss alternative means for imposing discipline on funding growth. 17/

2. <u>*Portability is Required by Law*</u>. It is beyond dispute that the law, as consistently interpreted by the Commission and upheld by the courts, requires funding portability – *i.e.*, a system in which the same amount of support per line or customer connection be available regardless of which carrier provides the service. As the U.S. Court of Appeals for the Fifth Circuit held, "portability is not only consistent with [the statutory principle of] predictability, but also is dictated by the principles of competitive neutrality and the statutory command [of section 254(e)]." 18/ The Commission itself has stated that "it is difficult to see how [a non-portable funding mechanism] could be considered competitively neutral" because "a mechanism that offers non-portable support may give ILECs a substantial unfair price advantage in competing for customers." 19/

3. <u>*Competitive Neutrality Promotes Economic Efficiency*</u>. Competitive neutrality is valuable not only because the law requires it. As the Joint Board recently recognized, "universal service payments should not distort the development of nascent competitive markets. Universal service support should neither incent nor

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17/ Restricting the overall growth of the fund would provide substantial benefits to carriers and consumers across the country who pay into the fund. *See* U.S. Chamber of Commerce, *Sending the Right Signals: Promoting Competition Through Telecommunications Reform* (Sept. 22, 2004) (estimating economic benefits of reducing or eliminating universal service contribution requirements and other regulations).

18/ *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 622 (5th Cir. 2000) ("*Alenco*").

19/ *Kansas USF Declaratory Ruling* , 15 FCC Rcd at 16232, ¶ 10. The Commission also has specifically considered and rejected arguments that portable support based on ILEC costs gives an unfair advantage to competitors. *Universal Service First Report and Order*, 12 FCC Rcd at 8933, ¶ 289.

discourage competitive entry." 20/ This is not merely a catchy slogan. In fact, a universal service system that, to the extent possible, avoids interfering with competitive market dynamics tends to maximize economic efficiency. 21/

Only a mechanism that disburses equal amounts of support per customer connection can avoid interfering with competitive dynamics, as the Commission has held. 22/ If one carrier experiences lower costs per line and therefore receives less support per line than a competing carrier, then the system effectively would penalize the more efficient carrier – and would give all carriers incentives to operate as inefficiently as possible so as to maximize their costs and their support payments. By contrast, if all eligible carriers in an area receive the same amounts of per-line support (or no support), then each competitor would have natural marketplace incentives to operate as efficiently as possible, and the carrier that is most successful in doing so would be able to exploit the benefits of its efficiency by offering higher-quality services and new technologies, cutting prices for consumers, earning greater margins, or some combination of these benefits. This, of course, is the competitive marketplace's mechanism to give service providers incentives to deliver the highest value to consumers at the lowest price. 23/

20/ *Primary Line/ETC Designation RD*, ¶ 96.

21/ *See* David E. M. Sappington, "Harnessing Competitive Forces to Foster Economical Universal Service," attached to GCI Comments, CC Docket No. 96-45 (May 5, 2003); *Kansas USF Declaratory Ruling*, 15 FCC Rcd at 16231, ¶ 8.

22/ *Kansas USF Declaratory Ruling* , 15 FCC Rcd at 16231, ¶ 8.

23/ Moreover, as Western Wireless has shown on a number of occasions, the existing rural support mechanism flunks competitive neutrality by funding rural ILECs in a manner designed to target their earnings to a guaranteed rate-of-return, assuring support regardless of whether the ILECs gain or lose customers, while placing CETCs' investments at risk and providing only

4. *Regulators Should Focus On Consumers' Needs, Not Carriers' Revenue Requirements*. "The purpose of universal service is to benefit the customer, not the carrier. . . . 'Sufficient' funding of the customer's right to adequate telephone service can be achieved regardless of which carrier ultimately receives the subsidy." 24/ The purpose of funding is *not* to guarantee carriers' recovery of their embedded-cost-based revenue requirements – nor, contrary to some parties' advocacy, is the fund's purpose to support "networks," whether operated by a single monopolist or multiple competing carriers. To be sure, carriers construct networks, not individual customer lines. But incumbent and competitive ETCs, like all other companies competing in a capitalist economy, should receive revenues *only* to the extent that they manage to persuade consumers to purchase their product. 25/ Policymakers must avoid "confus[ing] the requirement of sufficient support for universal service within a market in which telephone service providers compete for customers, which federal law mandates, with a guarantee of economic success for all providers [or for a selected subset of preferred providers], a guarantee that conflicts with competition." 26/

To ensure that the rural universal service mechanism is focused on *consumers* rather than carriers, the Joint Board and the Commission should not

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per-line support. *See, e.g., WW ROR Petition for Rulemaking* at 18-20. And capping CETC "cost-based" support at the level of ILEC support, but not capping ILEC support at the level of CETC support, would be a blatant and obvious violation of the competitive neutrality principle.

24/ *Alenco*, 201 F.3d at 621; *see also Primary Line/ETC Designation RD*, ¶ 57 & n.146.

25/ Socialist economies notoriously operated on the principle of "if you build it, they will come" – continuing to subsidize enterprises regardless of how inefficiently they operated or how badly they satisfied customers' demands.

26/ *Alenco*, 201 F.3d at 625.

grant support to either incumbent or competitive ETCs based on embedded costs or revenue guarantees. Revenue guarantees to ILECs interfere with those carriers' incentives to meet consumers' needs. 27/ Similarly, funding CETCs based on their "own" embedded costs, while doing nothing substantive to remedy the current ILEC funding regime would, in effect, extend the inefficient system of rate-of-return regulation to CETCs. Moreover, such a system also would be utterly impractical to implement, as even rural ILECs' representatives recognize. 28/

B. The Joint Board and the Commission Should Develop A "Unified" Universal Service Plan.

Rather than establishing a separate, new universal service mechanism for CETCs or considering minor tweaks to the rural ILEC funding rules, the Joint Board and the Commission should overhaul the system to be consistent, logical, and "unified" for all carriers serving similarly situated areas. 29/ The Commission is seeking to move toward a "unified intercarrier compensation regime." 30/ The need for unified, consistent rules applies with even greater force to high-cost universal

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27/ *See WW ROR Petition* at 20-24; *Lost in Translation, passim*.

28/ *See, e.g.,* USTA Comments, CC Docket No. 96-45, at 7 (filed May 5, 2003) ("Because the regulatory reporting requirements vary significantly between ILECs and competitive ETCs, it may be difficult for competitive ETCs to report their own cost data in a manner similar to the method used by ILECs, and it may be impractical to base the level of USF service support on each carrier's individual costs.").

29/ *Cf. Referral Order*, ¶ 7 (this proceeding should review "how the rural and non-rural high-cost support mechanisms function together"); *Public Notice*, ¶ 6.

30/ *Developing a Unified Intercarrier Compensation Regime*, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001) ("*Intercarrier Compensation NPRM*"). Intercarrier compensation reform proponents have strongly emphasized the need for a "single unified rate structure" for intercarrier compensation, "uniform rates for all [intercarrier] traffic," and a "single set of rules" governing financial responsibility for traffic exchange. Ex Parte Brief of the Intercarrier Compensation Forum in Support of the Intercarrier Compensation and Universal Service Reform Plan, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, at 5 (filed Oct. 5, 2004) ("*ICF Brief*").

service funding policy. The Commission and the Joint Board have long recognized the need for a "comprehensive review of the rural and non-rural funding systems and the need to "harmonize" the divergent systems. 31/ The time has now arrived to develop such a harmonized system, in time to be implemented in 2006 upon the expiration of the Rural Task Force plan.

The existing mechanisms provide vastly different forms of support to different categories of carriers, even when they provide service to the same (or similarly situated) customers. Rural ILECs receive support that, for the most part, is intended to produce a specified rate-of-return on embedded costs, via four separate mechanisms: High-Cost Loop Support ("HCL"), Local Switching Support ("LSS"), Interstate Common Line Support ("ICLS"), and Interstate Access Support ("IAS") (for rural ILEC operating companies subject to price cap regulation). So-called "non-rural ILECs" serving rural areas receive support based on forward-looking costs (but only in 10 states) plus IAS funding tied to their previous access charge rate levels. CETCs receive the per-line equivalent of whatever the ILEC receives, but only to the extent they attract consumers, and with no revenue guarantees. It makes no sense to maintain totally different funding systems that vary depending on the technology used by a carrier, the size of the carrier, or the regulatory history of the carrier.

31/ *See, e.g., Universal Service First Report & Order*, 12 FCC Rcd at 8934-35, ¶¶ 292-93; *Federal-State Joint Board on Universal Service*, Fourteenth Report and Order, 16 FCC Rcd 11244, 11310-11, ¶¶ 169-73 (2001) ("*RTF Order*"); *Primary Line/ETC Designation RD*, ¶¶ 94-96.

Moreover, there is little logic to the complex and arcane formulae used to determine the amounts of HCL, LSS, ICLS, and IAS funding received by rural ILECs and CETCs competing with them. 32/ The Commission has long recognized that those formulas, and the rate-of-return regulatory construct on which they are largely based, encourage inefficiency, discourage technological innovation, bear little relationship to the actual costs that drive economic decision-making in the real world, and are based on self-reported accounting records that have never been audited or scrutinized by independent auditors or regulators. 33/

Finally, rural ILECs continue to receive a substantial amount of *implicit* subsidies – funded through excessive access charges and other interstate and intrastate rate structures – which are largely or entirely unavailable to

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32/ The Intercarrier Compensation Forum's indictment of the existing hodge-podge of interconnection regimes is strikingly applicable to the existing hodge-podge of high-cost universal service regimes: "The telecommunications industry today is characterized by a patchwork of disparate intercarrier compensation schemes that were adopted piecemeal over the decades to address discrete regulatory problems. As a result, legacy regulatory classifications ('local,' 'toll,' EAS, CMRS, 'enhanced,' interstate, intrastate, interLATA, intraLATA, intraMTA, etc.) prescribe radically divergent compensation rules for indistinguishable telecommunications functions. By treating like functions differently, these disparate schemes create artificial and uneconomic distinctions among carriers and types of traffic. These legacy distinctions are no longer sustainable or meaningful in an age of competition, rapid technological evolution, and industry-wide convergence on IP-enabled platforms. They distort investment, create regulatory uncertainty, and impose enormous transaction costs . . . ." *ICF Brief* at 2-3.

33/ *See WW ROR Petition* at 8-31. Western Wireless applauds the Wireline Competition Bureau's recent decision to institute an investigation of the Rates of Return earned over the past decade by the ILECs participating in tariffs filed by the National Exchange Carrier Association ("NECA"). *See July 1, 2004 Annual Access Charge Tariff Filings*, Order Designating Issues for Investigation, WC Docket No. 04-372, DA 04-3020 (WCB, released Sept. 20, 2004). While this investigation is important and potentially valuable, it unfortunately comes as a bit too little, too late. The NECA tariff investigation focuses only on potential abuses reflected in access charges, not universal service payments; it will result, at most, in refunds of excessive access charges imposed since July 2004; and most significantly, it does nothing to change the basic rate-of-return regulatory system that created the incentives and opportunities for the NECA companies to engage in the corporate misconduct that led to their over-earnings in the first place.

wireless CETCs. These continued implicit subsidies violate a series of court decisions consistently holding that implicit subsidies are unlawful. 34/ As part of a newly "unified" system of rural universal service support, all implicit subsidies should be eliminated to ensure that all carriers serving a given rural area should receive the same support, regardless of the technology they use or their regulatory history.

Although ILECs and CETCs receive the same amount of explicit universal service support on a per-line basis, ILECs receive significantly more universal service support on a study area basis, even though both the ILEC and CETC must serve all consumers within designated service areas. For example, Electra Telephone in Texas receives $1,283,496.00 per year in federal universal service support, but a competitive carrier with 25% market share (490 customers) in the Electra Telephone study area receives only $321,365.00 per year based upon $54.65 per line in federal universal service support. 35/ Not only do ILECs receive more in federal universal service support than CETCs for serving the same area, but they also receive significant implicit universal service support through access charges and other support mechanisms that are unavailable to wireless CETCs. Electra Telephone, for example, receives approximately $1,638,713.50 per year in

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34/ *See, e.g., Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999) ("*Texas OPUC I*"); *Alenco*; *Comsat Corp. v. FCC*, 250 F.3d 931 (5th Cir. 2001).

35/ Based upon USAC 4th quarter 2004 projections, Electra receives $106,958.00 per month in universal service support for 1,957 working loops, which equates to $54.65 per line per month, which equals $1,283,496.00 per year in federal universal service support. In contrast, a CETC with 25% market share or 490 customers receives $321,342.00 per year in federal universal service support (490 customers times $54.65 per customer per month).

implicit universal service support, based upon $69.78 in per-line per month implicit universal service support, which is not available to wireless CETCs. 36/ So it is a complete fallacy that CETCs are over-recovering their costs through the federal universal service system. To the contrary, the current system provides CETCs with a small fraction of the support – explicit and implicit – flowing to the ILECs: in the Electra Telephone example, $2,922,209.50 per year to the ILEC compared to $321,365.00 to the CETC. 37/

Western Wireless recognizes that there is a great degree of diversity among rural carriers – *i.e.*, rural ILECs are different from one another, and are even more different from other "rural carriers" 38/ such as wireless carriers and carriers using other technologies. Nonetheless, there is no substance behind the oft-repeated, but facile, slogan that "*one size does not fit all*." 39/ In the universal service funding context, maintaining different funding systems for different sizes or types of carriers violates competitive and technological neutrality, undermines competition, and harms consumers. Instead of the existing complex assortment of inconsistent funding systems, the Joint Board should work to develop a "unified" system of high-cost support for rural areas. This effort is comparable to, and should

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36/ $1,638,713.50 per year in implicit universal service support is based upon $69.78 in per-line per month implicit support times 1,957 working loops. *See Lost in Translation* at 14-20.

37/ $2,922,209.50 per year is based upon $1,638,713.50 in implicit support plus $1,283,496.00 per year in explicit federal universal service support. Note that both Electra Telephone and CETCs would also receive state universal service support from the Texas state fund.

38/ *See supra* note 5.

39/ *See, e.g., RTF Order*, 16 FCC Rcd at ¶ 4.

proceed in tandem with, efforts to develop a "unified" system of intercarrier compensation. 40/

C. The Existing Rate-of-Return Regulatory System is Fatally Flawed and Must be Replaced

Western Wireless has shown that the existing rural high-cost mechanism, based on the RLECs' embedded cost and targeted to guarantee those carriers a specified rate of return ("ROR"), is fatally flawed. We are attaching copies of Western Wireless' Petition for Rulemaking to Eliminate Rate of Return Regulation of Incumbent Local Exchange Carriers and Western Wireless' Reply Comments on that petition, in which we made the case that the time has come to replace ROR regulation with a forward-looking system. 41/ The Joint Board's *Public Notice* effectively grants a significant part of the relief requested in that petition by initiating this rulemaking proceeding on, among other things, whether to fund rural ILECs and their competitors based on forward-looking economic costs, rather than based on ROR regulation.

In short, the Petition makes the following points regarding why the current system of rural high-cost funding, based on ROR regulation, must be eliminated:

> First, the system of ROR regulation, designed for a monopoly environment, has no place in an environment of local competition. The ROR system targets RLECs' access rates and high-cost support to achieve a guaranteed return on investment on all historical costs incurred, while RLECs' emerging ETC competitors receive funding only on a per-line basis for those

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40/ *See Intercarrier Compensation NPRM.*

41/ *WW ROR Petition*; *WW ROR Reply*; *Lost in Translation.*

> lines served. Unlike incumbent carriers, competitive entrants' investments are at risk. ROR regulation's reliance on the RLECs' historical costs is also inconsistent with the advent of local competition, since – as the Commission has long recognized, and as the Supreme Court recently affirmed, forward-looking costs are the only true measure of the factors that drive economic decision-making.
>
> Second, as the Commission has repeatedly recognized, ROR regulation interferes with incentives for carriers to operate efficiently, deploy new technologies, and reduce their operating costs. In today's increasingly competitive environment, it makes no sense to retain a system that gives carriers incentives to operate inefficiently and discourages them from introducing technological innovations. The ROR system, which rewards carriers for being small and inefficient, also creates artificial and inefficient incentives for RLECs to remain as small as possible, and for larger ILECs to sell exchanges to smaller carriers, even if it would be economically efficient for RLECs to combine or for larger carriers to operate those exchanges.
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> Third, ROR regulation is the true cause for the growth of the high-cost universal service fund, which threatens the long-term viability of the fund. A universal service funding mechanism based upon ROR regulation, the almost complete lack of independent oversight over the RLECs' cost reporting, and legal restrictions on the Commission's ability to require refunds or other remedies if and when it detects ROR over-earnings, leaves the public exposed to a very serious risk of fraud, waste, and abuse. In this "era of corporate governance problems and accounting depredations," this risk should be unacceptable. 42/

Western Wireless has also submitted an economic analysis demonstrating that the ROR-based universal service funding system (1) enables some rural ILECs to incur excessively high "corporate operations" overhead costs and to reap large universal service payments as a result; (2) systematically drives rural ILECs to forego opportunities to obtain increased economies of scale; and

42/ *WW ROR Petition* at 4-5 (footnotes and citations omitted).

(3) enables numerous rural ILECs to earn rates of return far in excess of the authorized level. 43/

II. DEVELOP A NEW RURAL HIGH-COST SUPPORT MECHANISM BASED ON FORWARD-LOOKING COST

The Commission and the Joint Board should develop a new rural support mechanism that would provide funding to all carriers serving rural areas – including large and small ILECs and CETCs – based on a consistent methodology. Since different carriers have incurred different levels of costs in the past, the only way to establish a methodology that is carrier-neutral, but cost-based, is to rely on the forward-looking economic costs of the least-cost technology. The Commission has long recognized, and recently reiterated, that "it is forward-looking costs, not historical costs, that are relevant in setting prices in competitive markets," 44/ and that "mechanisms incorporating forward-looking economic cost principles would . . . provid[e] more accurate investment signals to potential competitors," 45/ as well as to incumbents, than mechanisms based on embedded costs.

Western Wireless' Petition for Rulemaking and other filings provide a rigorous and complete demonstration that "a rural support mechanism that bases support on forward-looking economic cost estimates . . . more efficiently and

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43/ *See generally Lost in Translation.*

44/ *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Services by Incumbent Local Exchange Carriers*, Notice of Proposed Rulemaking, 18 FCC Rcd 18945, ¶ 30 (2003) ("*TELRIC NPRM*"). *See also Verizon Communications, Inc. v. FCC*, 535 U.S. 467 (2002) (affirming use of forward-looking costs to set rates for unbundled network elements); *Texas OPUC I*, 183 F.3d at 411-417 (affirming use of forward-looking costs to calculate universal service support for high-cost areas served by non-rural ILECs).

45/ *Universal Service First Report and Order*, 12 FCC Rcd at 8935-36, ¶ 293.

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47/

effectively achieves the Act's goals" than the embedded cost-based mechanism, "provid[es] appropriate incentives for investment, innovation, and entry into the marketplace," and more effectively achieves "competitive and technological neutrality[.]" 46/ A forward-looking cost-based mechanism also provides stronger incentives for innovation, including investment in broadband and advanced services. 47/

The use of forward-looking costs as the standard for universal service payments is appropriate regardless of whether or not there are competitors in rural service areas. The fundamental goal of economic regulation of incumbent service providers who remain dominant in their markets (*i.e.*, retain market power) is to emulate the conditions that would exist in a competitive market. Participants in a fully competitive market must constantly innovate and find new ways to produce more and/or better services and products, at lower cost, in order to survive. Similarly, basing universal service payouts on forward-looking costs should stimulate rural carriers – incumbents and new entrants alike – to provide their services in a least-cost, efficient manner. Local service markets throughout America, including those in rural areas of the country, were not opened to competitors for the benefit of those competitors, but so that American telecommunications customers ultimately could enjoy the benefits of competition, *i.e.*, lower prices and better service. Competition was not introduced "for competition's sake", but for consumers' sake. Continuing to base the calculation of

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46/ *Public Notice*, ¶ 21.

47/ *Id.*, ¶ 22.

universal service payouts based upon the embedded costs of the rural ILECs, that do not reflect the discipline afforded by fully competitive markets or their surrogate, forward-looking economic costs, will deny rural consumers those benefits.

In the following sections, we discuss (1) the development of new methodologies for determining forward-looking costs in rural, high-cost areas; (2) new formulas for deriving support funding amounts based on cost levels; and (3) additional policy changes needed to fully eliminate implicit subsidies from rural ILEC rate structures. 48/

A. Develop a New Methodology for Determining the Forward-Looking Economic Cost in Rural, High-Cost Areas

Western Wireless maintains that the right way to create a market-based, efficient funding mechanism is to base universal service support upon the forward-looking economic costs of the least-cost technology. There are a number of different options, some of which could be pursued simultaneously, that could be used to achieve this objective and determine the forward-looking economic costs of providing universal service in each rural geographic area. These options, described in further detail below, include:

(1) use of the Synthesis Model or an alternative forward-looking economic cost model of ILEC networks, possibly with modified inputs that are more appropriate for rural areas;

(2) developing forward-looking cost estimates by taking data on ILECs' existing plant accounts and applying adjustments or modifications to develop the

48/ This approach addresses the Joint Board's advice to "recognize the distinction between the method of determining the cost basis of support and the method of calculating support, which together form a universal service support mechanism." *Public Notice*, ¶ 19.

forward-looking costs today of constructing a network that reflects the routing and topography of an incumbent carrier's existing facilities; 49/ or

(3) comparing ILEC forward-looking estimates with cost estimates generated from a *wireless*-specific model (or models reflecting other technologies, such as cable, satellite, and/or VOIP) to determine the least-cost facilities-based technology to serve a given area.

Western Wireless submits that the Joint Board should evaluate the options based on the following criteria: 50/

- *Accuracy*: Does the methodology accurately reflect the forward-looking economic costs of providing universal service? Accuracy cannot be evaluated simply based on a comparison with embedded cost amounts reported by the ILECs or with levels of support generated by the existing mechanisms.

- *Simplicity*: Is the methodology relatively easy for the Commission, USAC, and parties to implement? While all cost methodologies are inherently complicated, optimally the selected methodology should avoid excessive complexity. Simplicity is closely related to the established goals of *administrative practicality* and *predictability* (does the system generate support amounts that are relatively stable and predictable, and therefore facilitate investment planning by both incumbents and competitive entrants?).

- *Competitive and Technological Neutrality*. Does the methodology avoid either artificially promoting or impeding competition by ensuring the same support levels for all carriers serving a given geographic area? Ideally, a competitively and technologically neutral methodology should avoid making presumptions about the technologies carriers use to provide service – funding should ideally be based on the forward-looking cost of the *least-cost technology*.

The biggest question related to the use of forward-looking costs for determining universal service high-cost payouts is not *whether* forward-looking

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49/ *Cf. TELRIC NPRM*, ¶¶ 49-53.

50/ *Public Notice*, ¶ 27 ("what factors should be considered in designing a forward-looking economic cost model for areas served by rural carriers?"); *cf. Universal Service First Report and Order*, 12 FCC Rcd at ¶ 250 (criteria for evaluating forward-looking cost models); "Alternative Mechanisms for Sizing a Universal Service Fund for Rural Telephone Companies," Rural Task Force White Paper #3 (Aug. 2000) at 6-7 (criteria for evaluating rural funding mechanisms).

costs should be used, but *how* forward-looking costs should be developed. Western Wireless is confident that it is possible to develop useful forward-looking costs for rural carriers. Below, we outline several possible approaches for determining high cost support levels for rural carriers using forward looking costs. Adoption of any of these methods would result in a dramatic improvement in the way that universal service subsidies are calculated, and bring rural America all of the benefits discussed above.

Two of the methods discussed below involve modeling costs based upon traditional wireline technologies. The third method, the method Western Wireless advocates most strongly as a long term solution, involves modeling the forward looking costs of traditional wireline and alternative local service technologies (wireless, cable, etc.), with the universal service payout being pegged to the forward-looking cost of the least-cost technology.

1. <u>*Adopt Existing Forward-Looking Cost Models to Rural ILECs*</u>. Over the past eight years, the Commission and parties have invested a great deal of effort into developing "bottom-up" models to estimate the forward-looking economic costs of replicating ILEC networks, for purposes of both pricing unbundled network elements and setting universal service support levels. The Synthesis Model currently used to develop support levels in non-rural ILEC areas is one product of those efforts. One option for determining the forward-looking economic costs of universal service in high-cost rural areas would be to refine the Synthesis Model in

a manner that would make it better suited for rural areas. 51/ Over a year ago, Western Wireless submitted an economic analysis that outlines steps that would be needed to develop a workable rural forward-looking cost model. 52/

While some have criticized the application of Synthesis Model to areas served by rural ILECs, the criticism has focused primarily on the alleged inappropriateness of the model inputs used. For example, the Rural Task Force issued a White Paper in September 2000 that criticized the application of the Synthesis Model to rural ILEC areas in part because it used incorrect study area boundaries and generated incorrect line counts. 53/ An obvious fix would be to develop accurate input data. Those issues certainly can be addressed and the problems can be solved. 54/

Revised "bottom-up" models to estimate the forward-looking economic cost of replicating ILEC networks in an efficient manner would have the benefits of accuracy and competitive neutrality. 55/

51/ *Public Notice,* ¶ 28.

52/ James W. Stegeman, "Proposal for a Competitive and Efficient Universal Service High Cost Funding Model/Platform" ("*Stegeman Proposal*"), attached as Attachment I to Western Wireless Comments, CC Docket No. 96-45 (filed May 5, 2003) (attached hereto as Exhibit 5).

53/ "A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies," Rural Task Force White Paper #4 (Sept. 2000).

54/ *See, e.g., Stegeman Proposal* at 12-14; *Public Notice*, ¶ 29 (seeking comment on inputs). Forward-looking economic cost models should also incorporate a forward-looking cost of capital, representing the "forward-looking cost of obtaining debt and equity financing." *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 14599, ¶ 700 (1996), *subsequent history omitted.* This may be greater or less than the authorized 11.25% rate of return, which was set almost two decades ago. *Public Notice*, ¶ 39.

55/ The *Public Notice* (¶ 34) seeks comment on whether "proxy data like line counts, line density, or other measures be used to determine the cost of serving high-cost areas served by rural carriers" in lieu of gathering actual cost data. One possible approach to consider would be to carry out a full forward-looking economic cost analysis only for a representative sample of

2. *__Modeling the Forward-Looking Costs of Reproducing Existing ILEC Network Facilities__*. Some have criticized models such as the Synthesis Model for considering the forward-looking costs of hypothetical efficient networks rather than the forward-looking costs of networks that reflect the routing and topography of ILECs' existing facilities. An alternative forward-looking approach that would essentially estimate today's "reproduction cost" of existing wireline network facilities would take, as a starting point, the costs of the ILECs' existing plant, as reflected in the booked cost reported in its accounting systems (*i.e.*, USOA accounts). Next, adjustment factors (such as the Telecommunications Plant Index ("TPI") factors used by some state commissions in TELRIC proceedings) would be applied to the plant accounts to update the booked costs to reflect intervening cost trends. Thus, if a digital carrier system today costs 20% less than it did when installed five years ago, the cost recorded on the carrier's books would be adjusted to reflect today's lower price. In effect, the existing numbers (and miles) of loops would be multiplied by today's per-unit cost of copper and fiber transmission facilities. Similar analyses would be applied to other ILEC network facilities.

A different analysis would be needed to estimate forward-looking operating expenses and corporate overhead costs. For those factors, a benchmarking analysis could be used to develop the "best in class" companies for

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study areas. Next, an econometric regression analysis could be conducted to correlate easily measured cost-affecting input factors (*e.g.*, population density and special terrain and climate factors) with the cost levels generated by the methodology. This statistical analysis could be used to estimate cost levels in the remaining geographic areas based on projecting out the characteristics of the sample. While less accurate than a full study of each geographic area, such a statistical analysis can be surprisingly accurate, particularly if the sample is large enough and if the regression analysis looks at appropriate cost-affecting input factors.

each category of ILECs. 56/ To facilitate this comparative analysis, ILECs should be grouped into appropriate sets of comparable "peer groups" based on rankings for cost drivers such as population density, total line counts, and climate and terrain factors. For each "peer group" of carriers, a threshold would be set for "best in class" performance – say, for example, the lowest-cost 25% of carriers in the particular peer group. That threshold would be used to determine particular "best in class" benchmark levels of operating expense and corporate overheads (both expressed as percentages of the underlying capital costs), and those benchmark levels would be applied to all companies in the peer group to derive forward-looking estimates for operating expenses and corporate overheads.

A method like this might arguably produce cost results that would tend to be higher than what would result from a full "bottom-up" model to estimate forward-looking costs, because it would reflect the ILECs' actual in-place plant characteristics, including features of their networks that might be deemed inefficient relative to what could be achieved by constructing an entirely new network today. However, this approach could be simpler to implement in practice than a full forward-looking cost model approach (e.g., a reworking of the Synthesis Model to apply to rural ILECs). Moreover, this approach would avoid the controversy over whether the Synthesis Model and similar bottom-up cost models

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56/ For a discussion of business process benchmarking to identify "best practices" among comparable firms and apply those processes to another firm to improve its performance, *see generally* Robert C. Camp, *Business Process Benchmarking: Finding and Implementing Best Practices* (ASQC Quality Press, Milwaukee, WI 1995). *See also Lost in Translation* at 37-43 (application of benchmarking methodology to identify RLECs that incur inefficient corporate overheads).

are too "hypothetical," since it would not require any network modeling algorithms. Similarly, it could avoid the "black box" criticisms levied at many bottom-up cost models (such as those proffered by some ILECs in TELRIC proceedings), since it could be implemented readily in spreadsheet form and with full transparency of its formulas and inputs.

3. *Forward-Looking Costs of Wireless and Other Technologies*. As discussed above, over the long term, regardless of which forward-looking methodology is chosen, the forward-looking approach for purposes of determining high-cost support amounts should be calculated, for *all* carriers, based on the *lesser* of the forward-looking cost of ILEC network technology or the forward-looking cost of wireless network technology (or other commercially available and viable technologies). The Commission's costing analysis efforts in the context of universal service thus should not be limited to ILEC network costs. In some geographic areas, wireless networks may incur lower forward-looking costs to provide basic universal service -- although in other areas, wireline may be the least-cost technology. 57/ Other facilities-based network technologies, such as cable and certain types of VOIP, may also need to be considered.

Estimating forward-looking costs for these alternative technologies could take the form of a "bottom-up" cost modeling exercise comparable to the Synthesis Model used to estimate forward-looking ILEC costs. For example, in

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57/ For this purpose, both ILEC and CMRS cost models should estimate the cost of providing the supported services included in the "definition of universal service." *See Federal-State Joint Board on Universal Service*, Order and Order on Reconsideration, 18 FCC Rcd 15090 (2003) (reaffirming existing definition of "universal service").

1998, Western Wireless developed a Wireless Cost Model based largely on the HAI wireline model, but incorporating a wireless network module in place of the HAI model's standard wireline loop module. 58/ Other approaches could also be considered. Critically, however, the output of such a wireless cost model should be used ***not*** "only for those ETCs that use wireless technology," 59/ but, in combination with the wireline model, for ***all*** ETCs, including incumbent wireline carriers. All ETCs – incumbents and competitive carriers – should receive funding based on the forward-looking cost of the least-cost technology in any given geographic area.

B. Establish New Formulas for Computing Support Amounts for Rural, High-Cost Areas

In the Petition for Rulemaking, Western Wireless offered the following analysis of the methodology for computing support amounts based on forward-looking cost estimates: 60/

> Once the Commission has an analytical methodology in place to determine forward-looking costs for each specified geographic area, the next step is to establish the rules for deriving support amounts. Western Wireless submits that such rules should meet each of the following criteria:
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> (1) As directed by the Tenth Circuit, the methodology for all carriers, rural as well as non-rural, must be "sufficient" and must be targeted to advance the statutory goals of "affordable" rates in high-cost areas that are "reasonably comparable" to

58/ The Hatfield Wireless Model ("HWM") estimates the cost of wireless service, using cluster population data and ILEC traffic loads to determine cell site, equipment, and backhaul requirements, and using the transport, switching, signalling and other cost data from the HAI wireline model. *See Ex Parte* Letter from David L. Sieradzki, Counsel for Western Wireless Corp., to Magalie Roman Salas, FCC Secretary, CC Docket No. 96-45 (Aug. 26, 1998) ("*Western Wireless Model Ex Parte*") (attached hereto as Exhibit 6).

59/ *Public Notice*, ¶ 31.

60/ *WW ROR Petition* at 36-38.

those in urban areas. 61/ (2) The methodology must be competitively and technologically neutral. Thus, it should not make any difference whether the geographic area is served by a rural ILEC, a non-rural ILEC, a competitive ETC, or some combination. (3) The methodology should provide sufficient federal support for a carrier seeking to serve a given high-cost geographic area, regardless whether that area is located in a state with average costs that are above or below the national average. (4) The methodology should provide sufficient federal support to give states with costs well above the national average the resources to supply any needed intrastate support. (5) The methodology should include "inducements" for states to take any necessary intrastate actions to eliminate implicit support, as required by the 1996 Act. 62/

There are a number of possible approaches that would satisfy these objectives. Qwest Communications outlined one possible approach in its comments in the Tenth Circuit Remand proceeding. 63/ Under Qwest's proposal, the current high-cost support mechanisms (model-based support and Interstate Access Support) would be replaced by what Qwest called "Tier One" and "Tier Two" support. Tier One Support would be based on a simple comparison of the cost of service in each area with a national benchmark (such as the $31 benchmark currently used in determining support for non-rural carriers). Tier Two Support (like the Model-Based Fund today) would be designed to provide funding to the highest-cost states that have the least ability to generate needed intrastate funding based on the divergence between the statewide average cost and the national average, while at the same time ensuring that the most rural areas are eligible for federal universal service funding. While Qwest offered its proposal specifically for areas served by non-rural ILECs and their competitors, Western Wireless believes a similar approach could also be applied to areas served by rural

61/ *Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001). *See also Federal-State Joint Board on Universal Service,* Order on Remand, 18 FCC Rcd 22559, ¶¶ 36-48 (2003) ("*Tenth Circuit Remand Order*") (clarifying FCC's definitions of key terms).

62/ *Qwest Corp. v. FCC, supra.*

63/ Qwest Comments, CC Docket No. 96-45 (10th Circuit Remand Proceeding) (filed April 10, 2002); *see also Ex Parte* Letter from John W. Kure, Qwest, to Marlene H. Dortch, Secretary, CC Docket No. 96-45 (filed Oct. 1, 2003) (summarizing Qwest's position on the Tenth Circuit remand).

> ILECs and their competitors. The Commission should seek further comment on this idea. 64/

The new formula for computing support amounts should not include provisions that cap support "at the lesser of embedded or forward-looking costs." 65/ Such a restriction would unfairly preclude some carriers in high-cost areas from receiving more funding under a forward-looking system than under the current rules, and therefore would retain a vestige of the present, non-unified system. However, Western Wireless is confident that the overall size of the high-cost fund would be substantially smaller under a forward-looking system that narrowly targets support to the consumers in highest-cost areas who need it most. To ensure that the fund does not grow excessively in the future, fund growth caps could be incorporated into the methodologies used to determine amounts of support based on forward-looking costs. 66/

C. Eliminate Implicit Subsidies

In tandem with establishing a new "unified" high-cost universal service mechanism, the Commission should act to eliminate the remaining implicit

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64/ While the Commission did not adopt Qwest's proposal in the *Tenth Circuit Remand Order,* it did not altogether reject it either – the further NPRM mentions the proposal and seeks further comment on related issues. *See Tenth Circuit Remand Order FNPRM,* ¶ 130 n.420.

Another, similar alternative would be to provide increasing percentages of federal support for geographic locations of increasing cost. For example, the federal fund could provide 25% of the difference between the forward-looking cost and the benchmark average cost for locations with costs that are 135% to 150% of the national average; 50% for locations 150% to 200% of the average; 75% for locations 200% to 250% of the average; and 100% of the difference between the forward-looking cost and the benchmark average cost for locations with costs that are 250% of the national average.

65/ *Public Notice*, ¶ 24.

66/ *Public Notice*, ¶ 26.

subsidies in the rural ILECs' interstate and intrastate rate structures. 67/ With respect to interstate rates, these subsidies can be removed by further reducing the rural ILECs' excessive access charges to remove implicit subsidies (possibly, although not necessarily, in tandem with generic reform of intercarrier compensation). 68/ To the extent such rate increases are cost-justified, it would be reasonable to consider permitting rural ILECs to recover some of the foregone access revenues through increased interstate Subscriber Line Charges. Importantly, however, the Commission should not act as though it has an obligation to "make the ILECs whole" – *i.e.*, there is no need to ensure that every dollar of foregone access charges is recovered through SLC increases or universal service funding. No such obligation exists, 69/ particularly if the rate-of-return regulatory paradigm is discarded.

With respect to implicit subsidies embedded in intrastate rates, parties in the *Intercarrier Compensation* proceeding have engaged in a lengthy discussion of the question of the Commission's authority to order reforms of intercarrier compensation mechanisms that previously were regulated by state commissions. 70/ Western Wireless will not address this issue here. Suffice it to say, however, that the Commission, with the support of the Joint Board, clearly has authority to give

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67/ As noted above, implicit subsidies are prohibited by the Act. *See supra* note 34.

68/ The Commission began the process of eliminating these implicit subsidies in the *MAG Order*. *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, 16 FCC Rcd 19613 (2001) ("*MAG Order*"), *subsequent history omitted.*

69/ *See FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989); *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993); *Alenco*.

70/ *See, e.g., ICF Brief* at 28-38.

state commissions enforceable "inducements" to eliminate implicit subsidies from intrastate rates, by reducing the universal service support disbursed to ILECs whose basic residential rates fail to recover at least a minimal amount of revenue corresponding to an "affordable" rate under the statute. Western Wireless has discussed this proposal in a number of previous filings and continues to urge its adoption. 71/

III. ADOPT A NEW, COMPETITIVELY-NEUTRAL APPROACH TO DEFINING "RURAL" FOR UNIVERSAL SERVICE PURPOSES

Western Wireless submits that the definition of who and what is considered "rural" for universal service purposes should be based on the characteristics of particular *geographic areas* – not on the size, type, or other characteristics of individual carriers. 72/ For example, carriers of any size or type could be deemed rural when they serve geographic areas with a specified population density (*e.g.*, 15 persons per square mile or fewer), but not when they serve geographic areas with higher population densities. In other words, "the relative cost characteristics of the area served," driven by factors "such as the density of

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71/ *See, e.g., WW ROR Petition for Rulemaking* at 39-41.

72/ *Public Notice*, ¶¶ 8-17. We concur with the Joint Board that there is no legal requirement that the Commission track the statutory definition of "rural telephone company" in Section 3(37) of the Act when it designs the universal service support system. *See Public Notice*, ¶ 9. The "rural telephone company" definition affects unbundling obligations under Section 251(f) of the Act and ETC designation procedures under Section 214(e), but it has no impact on universal service funding determinations under Section 254. Moreover, there is no good public policy reason to disburse different amounts of funds to carriers based on whether or not they have "rural telephone company" status under the Act.

customer locations, rather than the lineage of the company or the number of lines served, should be used to determine whether support should be paid." 73/

A definition of "rural" based on geographic characteristics, rather than the characteristics of individual carriers, would facilitate adoption of a "unified" high-cost support system, in which all carriers – whether large or small ILECs, CLECs, or wireless ETCs – would receive funding based on the same formulas when they serve "rural" areas. (Under this approach, of course, many carriers are likely to be both "rural" and "non-rural" when they serve different geographic areas.) Such an approach would eliminate the differences that exist today between the disparate funding systems for so-called "rural" and "non-rural" carriers. It also would make it unnecessary to maintain rules like 47 C.F.R. § 54.305, which precludes purchasers of exchanges from non-rural ILECs from receiving "rural" support for those wire centers. 74/ There would be no need for a so-called "parent trap" rule, since support would be based on geography, not the identity of a carrier or its "parent."

Under this approach, there would be no need to consider any of the subsections of Section 3(37) of the Act in determining which areas are rural, 75/ and no reason to consider study area size 76/ or holding company size. 77/ Indeed,

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73/ *Public Notice*, ¶ 25.

74/ *Public Notice,* ¶¶ 48-49. If the current bifurcated approach is retained, however, then Section 54.305 must be retained and should be enforced more strictly than it is today (with few if any waivers).

75/ *Id.,* ¶¶ 9-11 & 14.

76/ *Id.*, ¶ 12.

77/ *Id.*, ¶ 13

ideally the traditional ILEC "study areas" should be irrelevant. Rather than defining "rural" status or other determinants of high-cost support based on ILEC network characteristics such as wire centers, exchanges, study areas, or LATAs, competitively and technologically neutral geographic units should be used. For example, ZIP Codes, counties, or census block groups could be used. One advantage of such an approach is that data on the specific geographic boundaries and other features of such geographic areas are more readily available to the public than ILEC wire center and study area boundaries.

IV. IMPLEMENT SHORT-TERM AND TRANSITIONAL RULE CHANGES PENDING LONG-TERM REFORM

In the Petition for Rulemaking to Eliminate Rate-of-Return Regulation, Western Wireless offered the following transition measures to ease the change-over to a new, forward-looking economic cost-based funding system. 78/

Western Wireless recognizes that it is proposing a significant transformation in the high-cost universal service system and in the way rural ILECs are regulated. Accordingly, Western Wireless believes that a gradual transition plan is appropriate, as follows.

> First, the new rules should not become effective until 2006, upon the expiration of the five-year period provided by the *RTF Order*, and should apply initially only to . . . non-rural ILECs and rural ILECs owned by relatively large holding companies [and to CETCs that compete with such ILECs]. The rules should be phased in more gradually for smaller rural ILECs. Second, a transitional mechanism should be established such that no carrier's high-cost support is reduced by more than

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78/ *Id.*, ¶ 31.

20% in any one funding year. Third, a "safety net" should be available under which a carrier could show, using clear criteria established in advance, that it needs additional support to avoid hardship.

In the *RTF Order*, the Commission determined that the key elements of that plan would remain in place for a five-year stability period, running through mid-2006. 79/ Similarly, in the *MAG Order*, the Commission concluded that the key features of the access charge reform plan adopted in that order should remain in place for the same five-year period. 80/ Western Wireless believes that the Joint Board and the Commission must keep their promises and deliver the regulatory stability that they promised to ILECs and competitive ETCs alike, which is crucial for investment and economic decision-making. However, it is certainly timely for the Commission to begin now to lay the groundwork necessary to begin eliminating rate-of-return regulation as of the end of the 5-year RTF stability period, as was presaged in the *RTF Order*. 81/

Western Wireless proposes that the new system of high-cost universal service funding and interstate access charge regulation be introduced in 2006, at the end of the five-year period of the RTF plan, and phased in gradually thereafter. Specifically, in 2006, the new universal service system should apply only to . . . non-rural ILECs and rural ILEC study areas with 100,000 or more lines in all affiliated study areas nationwide and/or 30,000 lines or more in all affiliated study areas statewide [as well as to CETCs that compete with such carriers]. The plan would be extended in 2008 to [ILECs and CETCs in] rural ILEC study areas with 50,000 or more lines in all affiliated study areas nationwide and/or 15,000 or more lines in all affiliated study areas statewide; and in 2010 to rural ILEC study areas with 20,000 or more lines in all affiliated study areas nationwide and/or 5,000 or more lines in all affiliated study areas statewide. The plan would not be applied to the smallest rural ILEC[ ] [study areas] until 2012.

In order to prevent "rate shock" to carriers whose support payments are reduced, Western Wireless suggests that, in

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79/ *RTF Order*, 16 FCC Rcd at 11309-10, ¶ 167.

80/ *MAG Order*, 16 FCC Rcd at 10, ¶ 15.

81/ *See RTF Order,* 16 FCC Rcd at ¶ 12.

> addition to the gradual implementation schedule proposed above, the plan be implemented in such a way that no ILEC study area loses more than a specified percentage (20 or 25 percent) of the amount of support it previously received in any one year. "Hold-harmless" support should be made available, in addition to the forward-looking cost-based support, to ease the transition process. Competitive ETCs operating in such a study area would receive a comparable amount of portable support (on a per-line basis) for each customer connection they serve.
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> Furthermore, as in the RTF plan, Western Wireless believes that a "safety net" supplementary support mechanism should be available. If a carrier can prove that, in its particular circumstances, the amount of support is not sufficient to provide the basic universal services, an additional safety net or supplemental mechanism should be available for a limited period of time. Specific criteria for such supplemental support would have to be adopted in advance. This would prevent rate shock and unduly rapid transitions for the RLECs, while ensuring an orderly change to the system based on forward-looking costs. 82/

In addition, the Commission should adopt a number of short-term modifications to the funding rules, beginning with the Joint Board's proposal to impose a cap on per-line funding in rural study areas with competition. 83/ In addition, the Joint Board and the Commission should consider several other measures to control fund growth, including the following:

- Cap the overall size of the high-cost fund to grow in proportion to the size of the interstate telecommunications market.
- Cap total high-cost support in a study area upon competitive ETC entry, and allocate the support among ETCs based on market share.
- For the sole purpose of computing embedded costs under the rate of return system, require holding companies to combine all "study areas" in each state.

82/ *WW ROR Petition* at 41-44; *see also WW ROR Reply Comments* at 13-14.

83/ *Primary Line/ETC Designation RD*, ¶¶ 77-80.

- Revise the local switching support mechanism to reflect economies of scale that can be achieved by carriers with fewer than 50,000 lines.
- Impose further restrictions on rural ILECs' ability to recover general overheads or "corporate operations expenses" through High-Cost Loop Support.

CONCLUSION

The Joint Board should recommend adoption of a "unified" forward-looking economic cost-based system for funding all carriers operating in rural areas, including large and small ILECs as well as CETCs, as discussed above and in the Exhibits to these comments.

Respectfully submitted,

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